KPMG Peat Marwick LLP

2001 M Street, NW
Washington, DC 20036

INDEPENDENT AUDITORS' REPORT

To the Inspector General,
U.S. Department of Housing and Urban Development:

We have audited the 1997 and 1996 financial statements of the Government National Mortgage Association (Ginnie Mae). The objective of our audits was to express an opinion on the fair presentation of Ginnie Mae's financial statements based on our audits. In connection with our audits we also considered Ginnie Mae's internal control and tested Ginnie Mae's compliance with provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

In our opinion, Ginnie Mae's 1997 and 1996 financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles.

We noted no matters involving internal control and its operations that we consider to be material weaknesses.

The results of our tests of compliance disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements,* as amended.

Our opinion on Ginnie Mae's financial statements, our consideration of internal control, our tests of Ginnie Mae's compliance with certain laws and regulations and our responsibilities are discussed in the remainder of our report.

OPINION ON FINANCIAL STATEMENTS

We have audited the accompanying balance sheets of Ginnie Mae, as of September 30, 1997 and 1996, and the related statements of revenues and expenses and changes in investment of U.S. government and cash flows for the years then ended. These financial statements are the responsibility of Ginnie Mae's management. Our responsibility is to express an opinion on these financial statements based on our audits.

In our opinion, the accompanying 1997 and 1996 financial statements present fairly, in all material respects, the financial position of Ginnie Mae as of September 30, 1997 and 1996, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

The Office of Inspector General (OIG) is required to conduct an annual audit of Ginnie Mae under the provisions of the Chief Financial Officers (CFO) Act of 1990. To fulfill that responsibility, OIG contracted with the independent certified public accounting firm of KPMG Peat Marwick LLP to conduct the audit for the year ended September 30, 1997. The complete OIG report (98-FO-171-0002) is included in the separate management report Ginnie Mae prepared pursuant to the CFO Act which is available upon request from Ginnie Mae.

INTERNAL CONTROLS

We noted no matters involving internal control and its operation that we consider to be material weaknesses or reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06, as amended.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements of Ginnie Mae may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls that, in our judgment, could adversely affect Ginnie Mae's ability to ensure that the objectives of the internal controls, as defined, are being achieved.

Our consideration of internal control would not necessarily disclose all internal control matters that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses, as described above.

Although not considered material weaknesses, we noted other matters during our audit which have been reported to Ginnie Mae's management in a separate letter.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests, performed as part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* and OMB Bulletin No. 93-06, as amended.

RESPONSIBILITIES

Management's Responsibility. The Chief Financial Officers (CFO) Act of 1990 requires federal agencies to report annually to Congress on their financial status and any other information needed to fairly present the agencies' financial position and results of operations. To meet the CFO Act reporting requirements, Ginnie Mae prepares annual financial statements. Ginnie Mae is an agency operated by the U.S. Department of Housing and Urban Development (HUD).

Management has the responsibility for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing and maintaining internal controls; and
- complying with applicable laws and regulations.

In fulfilling these responsibilities, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that:

- transactions are executed in accordance with management's authorization and are properly recorded and accounted for to permit the preparation of reliable financial statements in conformity with generally accepted accounting principles, and to maintain accountability over assets;

- funds, property, and other assets are safeguarded from unauthorized use or disposition; and

- transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements.

Auditors' Responsibility. Our responsibility is to express an opinion on the 1997 and 1996 financial statements of Ginnie Mae based on our audits. We conducted our audits in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and OMB Bulletin No. 93-06, as amended, except for those portions of the Bulletin that relate to the review of performance measures. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement and presented fairly in accordance with generally accepted accounting principles. We believe that our audits provide a reasonable basis for our opinion. Our audits were not designed to test the requirements of OMB Bulletin No. 93-06, as amended, relating to the *Federal Financial Management Improvement Act* (FFMIA), as FFMIA is not considered applicable at the Ginnie Mae level. FFMIA requirements will be reviewed and reported on at the HUD consolidated level.

In planning and performing our audit of the financial statements of Ginnie Mae, we considered internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on internal control over financial reporting. Accordingly, we do not express such an opinion.

As part of obtaining reasonable assurance about whether Ginnie Mae's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations. However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

In order to fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;

- assessed the accounting principles used and significant estimates made by management;

- evaluated the overall financial statement presentation; and

- tested compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 93-06, as amended.

With respect to internal control, we obtained an understanding of the design of relevant policies and procedures, determined if they had been placed in operation, assessed control risk, and performed tests of internal controls.

Because of inherent limitations of internal control, fraud may nevertheless occur and not be detected. Also, projection of an evaluation of internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

This report is intended solely for the use of the HUD Office of the Inspector General, the management of HUD and Ginnie Mae, and Congress. However, this report is a matter of public record and its distribution is not limited.

February 12, 1998
Washington, D.C.

BALANCE SHEETS

	September 30, 1997	1996
	(In thousands)	
Assets:		
Funds in U.S. Treasury	$ 155,800	$ 131,200
U.S. Government securities-Note B	5,382,000	4,785,100
Mortgages held for sale, net-Note C	3,800	1,200
Properties held for sale, net-Note D	3,000	5,600
Accrued interest and other receivables	101,700	83,900
Advances against defaulted Mortgage-Backed Security pools, net-Note E	29,100	29,500
Claims against HUD/FHA and VA	7,500	5,900
	$ 5,682,900	**$ 5,042,400**
Liabilities and Investment of U.S. Government		
Liabilities:		
Reserve for loss on Mortgage-Backed Securities Program-Note F	$ 507,700	$ 471,700
Deferred revenue	19,200	14,800
Deferred liabilities/deposits	1,700	1,800
Accounts payable and accrued liabilities	19,700	20,700
	$ 548,300	**$ 509,000**
Commitments and Contingencies-Note I		
Investment of U.S. Government	**5,134,600**	**4,533,400**
	$ 5,682,900	**$5,042,400**

See accompanying notes to financial statements.

STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN INVESTMENT OF U.S. GOVERNMENT

	Year ended September 30, 1997	1996
	(In thousands)	
Revenues:		
Mortgage-Backed Securities Program income	$ 353,800	$ 335,200
Interest income	318,200	274,100
Other income, net	14,700	11,700
Total Revenues	**686,700**	**621,000**
Expenses:		
Mortgage-Backed Securities Program expenses	29,400	27,100
Administrative and other expenses	9,300	9,100
Total Expenses	**38,700**	**36,200**
Provision for loss on Mortgage-Backed Securities Program-Note F	46,800	69,300
Excess of Revenues Over Expenses	**601,200**	**515,500**
Investment of U.S. Government at Beginning of Year	**4,533,400**	**4,033,300**
Excess of revenues over expenses	601,200	515,500
Returned to U.S. Treasury	0	(15,400)
Investment of U.S. Government at End of Year	**$ 5,134,600**	**$ 4,533,400**

See accompanying notes to financial statements.

STATEMENTS OF CASH FLOWS
INCREASE (DECREASE) IN CASH

	Year ended September 30, 1997	1996
	(In thousands)	
Cash flows from operating activities:		
Interest received	$ 301,800	$ 279,400
Mortgage-Backed Securities Program fees	352,400	333,600
Advances against defaulted Mortgage-Backed Security pools	(5,100)	(6,800)
Mortgage-Backed Securities Program losses and expenses	(36,300)	(30,900)
Other income received	23,300	20,000
Administrative expenses	(9,300)	(9,100)
Purchases of mortgages/properties, net of disposal	(15,900)	(1,200)
Recoveries from FHA and VA	10,600	5,500
Net cash provided by operating activities	**621,500**	**590,500**
Cash flows from investing activities:		
Purchase of U.S. Treasury Securities, net	(596,900)	(536,500)
Net cash used by investing activities	**(596,900)**	**(536,500)**
Cash flows from financing activities:		
Cash returned to U.S. Treasury	0	(15,400)
Net cash used by financing activities	**0**	**(15,400)**
Net increase in cash	**24,600**	**38,600**
Funds in US Treasury at beginning of year	**131,200**	**92,600**
Funds in US Treasury at end of year	**$ 155,800**	**$ 131,200**

See accompanying notes to financial statements.

STATEMENTS OF CASH FLOWS - RECONCILIATION OF NET EXCESS OF REVENUES OVER EXPENSES TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	Year ended September 30, 1997	1996
	(In thousands)	
Net excess of revenue over expenses	**$ 601,200**	**$ 515,500**
Adjustments to reconcile net excess of revenue over expenses to net cash provided by operating activities:		
Provision for loss on Mortgage-Backed Securities Program	46,800	69,300
(Increase) decrease in accrued interest and other receivables	(16,400)	5,200
Decrease in advances against defaulted Mortgage-Backed Security pools	400	48,900
Decrease in deposit liabilities	(100)	(8,000)
(Decrease) increase in accounts payable and accrued liabilities	(1,000)	1,600
Increase in deferred revenue	4,400	4,200
Decrease in Mortgage-Backed Securities reserve relating to operating activities	(13,800)	(46,200)
Total adjustments	**20,300**	**75,000**
Net cash provided by operating activities	**$ 621,500**	**$ 590,500**

See accompanying notes to financial statements.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

NOTES TO THE FINANCIAL STATEMENTS

NOTE A--ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Government National Mortgage Association (Ginnie Mae) was created in 1968 through amendment of Title III of the National Housing Act as a Government corporation within the Department of Housing and Urban Development (HUD).

The mortgage-backed securities (MBS) program is Ginnie Mae's primary ongoing activity. The purpose of the program is to increase liquidity in the secondary mortgage market and attract new sources of capital for residential loans. Through the program, Ginnie Mae guarantees the timely payment of principal and interest on securities backed by pools of mortgages issued by private mortgage institutions. The guaranty is backed by the full faith and credit of the United States Government. Ginnie Mae requires that the mortgages be insured or guaranteed by the Federal Housing Administration (FHA), the Rural Housing Service (RHS), (formerly Farmer's Home Administration), or the Department of Veterans Affairs (VA).

These MBS securities are not assets of Ginnie Mae, nor are the related outstanding securities liabilities; accordingly, neither is reflected on the accompanying balance sheets.

Funds in U.S. Treasury: All of Ginnie Mae's receipts and disbursements are processed by the U.S. Treasury which, in effect, maintains Ginnie Mae's bank accounts. For purposes of the Statement of Cash Flows, Funds in U.S. Treasury are considered cash.

U.S. Government Securities: Ginnie Mae classifies its investments in U.S. Government Securities based on its ability and positive intent to hold them to maturity. Therefore, Ginnie Mae's investment in U.S. Government securities is recorded at amortized cost. Discounts and premiums are amortized over the life of the related security.

Mortgage Loans Held for Sale: Mortgage loans held for sale are carried at the lower of cost or fair value, with any unrealized losses included in current period earnings. The related allowance for loss is established to reduce the carrying value of mortgages held for sale to their estimated fair value which is based on the amount Ginnie Mae expects to realize in cash upon sale of the mortgages.

Properties Held for Sale: Foreclosed assets are recorded at the lower of cost or fair value less estimated costs to sell. The related allowance for loss is established to reduce the property carrying value to fair value less costs to sell. Property related expenses incurred during the holding period are included in Mortgage-Backed Securities program expenses.

Advances Against Defaulted Mortgage-Backed Security Pools: Advances against defaulted mortgage-backed security pools represent payments made to fulfill Ginnie Mae's guaranty of timely principal and interest payment to the MBS security holders. Such advances are reported net of an allowance for doubtful recoveries to the extent management believes they will not be recovered. The allowance for doubtful recoveries is estimated based on actual and expected recovery experience and is adjusted for FHA, VA and RHS claims that have been filed.

Reserve for Loss on MBS Program: In the operation of its MBS programs, Ginnie Mae estimates the present value cost of liquidating its existing portfolio of mortgage servicing rights acquired from defaulted issuers and expected future issuer defaults. Reserves are established to the extent management believes issuer defaults are probable and FHA, VA and RHS insurance or guarantees are insufficient to recoup Ginnie Mae expenditures. The reserves are increased by provisions charged as an expense in the Statements of Revenues and Expenses and reduced by charge-offs, net of recoveries.

Recognition of Revenues and Expenses: Ginnie Mae receives monthly guarantee fees for each MBS mortgage pool based on a percentage of the pool's outstanding balance. Fees received for Ginnie Mae's guaranty of mortgage-backed securities are recognized as earned. Fees received for commitments to guaranty mortgage-backed securities are recognized when the commitments are granted. Ginnie Mae recognizes as other income, net, the major portion of fees related to the issuance of multiclass securities in the period the fees are received, with the balance deferred and amortized as other income, net, over the weighted averaged life of the related mortgages to match the recognition of related administrative expenses. Losses on assets acquired through liquidation and claims against HUD/FHA and VA are recognized when they occur.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Pronouncements: The Federal Accounting Standards Advisory Board has issued the following pronouncements that become effective in the fiscal year ending September 30, 1998: Statements of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards;* SFFAS No. 6, *Accounting for Property, Plant and Equipment;* and SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.* SFFAS No. 4 requires tracking and reporting of costs that correspond to outputs of business objectives. SFFAS No. 6 provides disclosure requirements for property, plant and equipment acquired from other Federal entities. SFFAS No. 7 requires disclosures related to budgetary resources and custodial activity. Management believes that the adoption of SFFAS Nos. 4, 6 and 7 will not have a material effect on Ginnie Mae's reported results of operations or financial position.

NOTE B--U.S. GOVERNMENT SECURITIES

The U.S. Government Securities portfolio is held in special market based U.S. Treasury securities that are bought and sold at composite prices received from the Federal Reserve Bank of New York. These securities are maintained in book entry form at the Bureau of Public Debt. The coupon rates of Ginnie Mae's current holdings range from 5.0 percent to 8.0 percent. The amortized cost and fair values as of September 30, 1997 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Overnight Certificates	$ 217,800	$ 0	$ 0	$ 217,800
U.S. Treasury Notes	5,164,200	87,600	24,100	5,227,700
	$ 5,382,000	$ 87,600	$ 24,100	$ 5,445,500

The amortized cost and fair values as of September 30, 1996 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Overnight Certificates	$ 507,100	$ 0	$ 0	$ 507,100
U.S. Treasury Notes	4,278,000	35,400	72,400	4,241,000
	$ 4,785,100	$ 35,400	$ 72,400	$ 4,748,100

The amortized cost, fair value and annual weighted average interest rates of debt securities at September 30, 1997, by contractual maturity date, are as follows (dollars in thousands):

Maturity	Amortized Cost	Fair Value	Weighted Average Interest Rate
Due within one year	$ 498,000	$ 497,300	5.72%
Due after one year through five years	2,536,900	2,549,700	5.88%
Due after five years through ten years	2,347,100	2,398,500	6.13%
	$ 5,382,000	$ 5,445,500	5.98%

The amortized cost, fair value and annual weighted average interest rates of debt securities at September 30, 1996, by contractual maturity date, were as follows (dollars in thousands):

Maturity	Amortized Cost	Fair Value	Weighted Average Interest Rate
Due within one year	$ 879,700	$ 879,400	5.59%
Due after one year through five years	1,959,700	1,938,300	6.26%
Due after five years through ten years	1,945,700	1,930,400	6.65%
	$ 4,785,100	$ 4,748,100	6.29%

NOTE C--MORTGAGES HELD FOR SALE, NET

Ginnie Mae acquires certain mortgages from defaulted issuers' portfolios to bring the pools into conformity with MBS requirements. Mortgages ineligible to remain in pools when servicing-rights are sold are acquired by Ginnie Mae. Mortgages held for sale were as follows (in thousands):

	September 30, 1997	September 30, 1996
Unpaid principal balance	$ 7,000	$ 2,300
Allowance for doubtful recoveries	(3,200)	(1,100)
Mortgages held for sale, net	$ 3,800	$ 1,200

NOTE D--PROPERTIES HELD FOR SALE, NET

Ginnie Mae acquires residential properties by foreclosure out of the defaulted issuer portfolios in order to comply with MBS requirements. Balances and activity in the properties held for sale were as follows (in thousands):

	September 30, 1997	September 30, 1996
Cost of properties, beginning of year	$ 8,100	$ 6,500
Additions	23,000	20,100
Dispositions and losses	(26,400)	(18,500)
Cost of properties, end of year	4,700	8,100
Allowance for doubtful recoveries	(1,700)	(2,500)
Properties held for sale, net	$ 3,000	$ 5,600

NOTE E--ADVANCES AGAINST DEFAULTED MORTGAGE-BACKED SECURITY POOLS

Under its MBS guaranty, Ginnie Mae advanced $93.0 million in 1997 and $128.6 million in 1996 against defaulted mortgage-backed security pools to ensure timely pass-through payments. Recoveries of advances, either from late payment remittances or through FHA insurance or VA guaranty proceeds, were $84.4 million in 1997 and $128.3 million in 1996. Advances of $2.9 million were written off in 1997; there were $.4 million of write-offs in 1996.

Unrecovered advances outstanding against defaulted mortgage-backed security pools, net of allowance for doubtful recoveries, were as follows (in thousands):

	September 30, 1997	September 30, 1996
Advances against defaulted pools	$ 324,500	$ 318,800
Allowance for doubtful recoveries	(295,400)	(289,300)
Advances against defaulted pools, net	$ 29,100	$ 29,500

NOTE F--RESERVE FOR LOSS ON MBS PROGRAM

Ginnie Mae establishes a reserve for losses through a provision charged to operations when, in management's judgment, defaults of issuers of mortgage-backed securities become probable. The allowance for losses is based on an analysis of the MBS portfolio outstanding. In estimating losses, management utilizes a statistically based model that evaluates numerous factors, including, but not limited to, general and regional economic conditions, mortgage characteristics, and actual and expected future default and loan loss experience. Management also considers uncertainties related to estimations in the reserve setting process. The reserve is relieved as losses are realized from the disposal of the defaulted issuers' portfolios. Ginnie Mae recovers part of its losses through servicing fees on the performing portion of the portfolios and the sale of servicing rights which inure to Ginnie Mae upon the default of the issuer. Ginnie Mae management believes that its reserve is adequate to cover probable losses from defaults by issuers of Ginnie Mae guaranteed mortgage-backed securities. Changes in the reserve were as follows (in thousands):

	Single-Family	Multifamily	Manufactured Housing	Total
September 30, 1995	$ 150,000	$ 40,800	$ 265,000	$ 455,800
Recoveries	7,600	1,100	13,600	22,300
Realized Losses	(4,700)	(44,500)	(26,500)	(75,700)
Provision	(2,900)	59,300	12,900	69,300
September 30, 1996	$ 150,000	$ 56,700	$ 265,000	$ 471,700
September 30, 1996	$ 150,000	$ 56,700	$ 265,000	$ 471,700
Recoveries	13,100	11,100	18,500	42,700
Realized losses	(23,900)	(900)	(28,700)	(53,500)
Provision	57,000	(10,200)	0	46,800
September 30, 1997	$ 196,200	$ 56,700	$ 254,800	$ 507,700

Ginnie Mae incurs loss when insurance and guarantees do not cover expenses that result from issuer defaults. Such expenses include (1) unrecoverable losses on individual mortgage defaults because of coverage limitations on mortgage insurance or guarantees, (2) ineligible mortgages included in defaulted Ginnie Mae pools, (3) improper use of proceeds by an issuer, and (4) non-reimbursable administrative expenses and costs incurred to service and liquidate portfolios of defaulted issuers.

The reserve for losses is relieved as estimated losses are realized. To the extent realized losses differ from those previously estimated, Ginnie Mae may elect to increase or decrease its reserve depending on its assessment of risks and losses associated with probable issuer defaults. For fiscal year 1997 Ginnie Mae increased its provision for losses for its single-family portfolio to reflect increased risk with respect to recovery of certain losses and expenses associated with issuer defaults. At September 30, 1997, the balances of Ginnie Mae managed portfolios were $606.7 million in single-family, $0 in multifamily, and $220.3 million in manufactured housing, and in fiscal year 1996, $315.8 million in single-family, $38.0 million in multifamily and $332.2 million in manufactured housing. As Ginnie Mae's defaulted issuer portfolio decreases, original estimates are compared with actual results over time and the adequacy of the reserve is assessed and if necessary, the reserve is adjusted.

NOTE G--FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

Ginnie Mae is subject to credit risk for financial instruments not reflected in its balance sheet in the normal course of operations. These financial instruments include guarantees of mortgage-backed securities and commitments to guaranty mortgage-backed securities. The Ginnie Mae guaranteed security is a pass through security whereby mortgage principal and interest payments, except for servicing and guaranty fees, are passed through to the security holders monthly. Mortgage prepayments are also passed through to security holders. As a result of the structure of the security, Ginnie Mae bears no interest rate or liquidity risk. Ginnie Mae's exposure to credit loss is contingent on the event of non-performance by other parties to the financial instruments. Other than those issuers considered in the reserve for loss on the MBS program (see Note F), Ginnie Mae does not anticipate non-performance by the counterparties.

Ginnie Mae guarantees the timely payment of principal and interest to mortgage-backed security holders should the issuers fail to do so. The securities are backed by pools of insured or guaranteed FHA, RHS or VA mortgage loans. On September 30, 1997 the amount of securities outstanding which are guaranteed by Ginnie Mae was $531 billion; however, Ginnie Mae's potential loss is considerably less because the underlying mortgages serve as primary collateral and the FHA, RHS and VA insurance or guarantee serve to indemnify Ginnie Mae for most losses.

During the mortgage closing period and prior to granting its guaranty, Ginnie Mae enters into commitments to guaranty mortgage-backed securities. The commitment ends when the securities are issued or the commitment period expires. Ginnie Mae's risk related to outstanding commitments is much less than for outstanding securities due, in part, to Ginnie Mae's ability to limit commitment authority granted to individual issuers of mortgage-backed securities.

Outstanding MBS securities and commitments were as follows (in billions):

	September 30, 1997	September 30, 1996
Outstanding MBS securities	$ 531	$ 497
Outstanding MBS commitments	$ 31	$ 33

NOTE H--CONCENTRATIONS OF CREDIT RISK

Concentrations of credit risk exist when a significant number of counterparties (e.g., issuers and borrowers) engage in similar activities or are susceptible to similar changes in economic conditions that could affect their ability to meet contractual obligations. Generally, Ginnie Mae's MBS pools are diversified among issuers and geographic areas. No significant geographic concentrations of credit risk exist; however, to a limited extent, securities are concentrated among issuers as noted below as of September 30, 1997 (dollars in billions):

	Single-Family		Multifamily		Manufactured Housing	
Portfolios of	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance
Largest performing issuers	15	$ 336.4	10	$ 9.3	1	$ 0.9
Other performing issuers	329	178.5	131	4.3	5	0.3
Defaulted issuers	10	0.6	0	0.0	23	0.2

During fiscal year 1997, Ginnie Mae acquired 4 single-family issuer portfolios with a remaining principal balance of $350.6 million.

In fiscal year 1997, Ginnie Mae issued a total of $27.7 billion in its multiclass securities program. The outstanding balance at September 30, 1997 was $51.8 billion. These guaranteed securities do not subject Ginnie Mae to additional credit risk beyond that assumed under the MBS program.

NOTE I--COMMITMENTS AND CONTINGENCIES

As of September 30, 1997, Ginnie Mae was named in several legal actions, virtually all of which involved claims under the guarantee program. It is not possible to predict the eventual outcome of the various actions; however, in the opinion of management and counsel the resolution of these claims will not result in adverse judgments to such an extent they would materially affect the financial position or results of operations of Ginnie Mae.

NOTE J--RELATED PARTIES

Ginnie Mae is subject to controls established by government corporation control laws (32 U.S.C. 9101 through 9109) and management controls by the Secretary of HUD and the Director of the Office of Management and Budget (OMB). Such controls could affect Ginnie Mae's financial position or operating results in a manner that differs from those that might have been obtained if Ginnie Mae were autonomous.

HUD provides Ginnie Mae, without charge, use of office space and equipment. Ginnie Mae reimbursed HUD $9.3 million in 1997 and $9.1 million in 1996 for administrative expenses allocated to Ginnie Mae including payroll and payroll related costs.

Payroll related costs for which Ginnie Mae reimbursed HUD included matching contributions to the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). Although Ginnie Mae funds a portion of pension benefits under these programs, it has no liability for future payments to employees under these programs and does not account for the assets of CSRS or FERS nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management (OPM) and are allocated to HUD. OPM also accounts for the health and life insurance programs for Federal employees and retirees and funds the non-employee portion of the costs of such program.

Cash receipts, disbursements and investment activities are processed by the U.S. Treasury. Funds in the U.S. Treasury represent cash currently available to finance purchase commitments and pay current liabilities. Ginnie Mae has authority to borrow from the U.S. Treasury to finance its operations in lieu of appropriations if necessary.

NOTE K--FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table shows the fair value of financial instruments to which Ginnie Mae has a contractual obligation to deliver or a contractual right to receive cash from another entity as of September 30, 1997 and 1996 (in thousands):

	Fair Value	
Financial Instrument	1997	1996
U.S. Government Securities	$5,445,500	$4,748,100
Funds in U.S. Treasury	$155,800	$131,200
Advances against MBS Pools	$29,100	$29,500
Other Assets	$113,000	$91,000
Unrecognized Financial Instruments	$1,132,300	$1,086,00
Other Liabilities	$40,600	$37,300

The fair value of Ginnie Mae's largest asset, U.S. Government Securities, is estimated based on quoted market prices for securities of similar maturity. The fair values of Funds in U.S. Treasury, Advances against MBS Pools, Other Assets and Other Liabilities are not materially different from their carrying values.

Unrecognized financial instruments comprise the net fair value of the fee Ginnie Mae receives for the guarantee of timely payment of principal and interest. The value was derived by discounting the estimated future net cash flows relating to Ginnie Mae guaranteed mortgage-backed securities outstanding. The assumptions and estimates used in calculating the fair value of unrecognized financial instruments are based on management's evaluation of economic conditions and, therefore, are not subject to precise quantification. These discounted cash flows consist of estimated future guaranty fees, taking into account estimated prepayments, in excess of 1) projected losses relating to the MBS program, including projected losses on defaulted pools of mortgage-backed securities, and 2) projected administrative expenses. The discount rate approximates an interest rate for risk-free instruments of a tenor and duration similar to the Ginnie Mae guarantee. The fair value of Ginnie Mae's guarantee recognizes the present value of future fees which are not recognized under generally accepted accounting principles since to do so would record revenue prior to realization. The decrease in the fair value of unrecognized financial instruments is primarily attributable to the impact of interest rate volatility.

Ginnie Mae's standing as a Federal government corporation whose guarantee carries the full faith and credit of the U.S. Government makes it difficult to determine what the fair value of its financial instruments would be in the private market. Accordingly, the amount Ginnie Mae would realize upon sale of its financial instruments could differ, perhaps materially, from the amounts shown above.

NOTE L--CREDIT REFORM

The primary purpose of the Federal Credit Reform Act of 1990, which became effective on October 1, 1991, is to more accurately measure the cost of Federal credit programs and to place the cost of such credit programs on a basis equivalent with other Federal spending. Credit Reform focuses on those credit programs that operate at a loss by providing for appropriated funding, within budgetary limitations, to subsidize the loss element of the credit program. Negative subsidies, calculated for credit programs operating at a profit, normally result in the return of funds to Treasury. OMB specifies the methodology an agency is to follow in accounting for the cash flows of its credit programs.

Ginnie Mae's credit activities have historically operated at a profit. Ginnie Mae has not incurred borrowings or received appropriations to finance its credit operations, nor does it anticipate the need to receive such funding. As of September 30, 1997, Ginnie Mae had an investment in U.S. Government of $5.1 billion after establishing reserves for potential losses on its credit activities. Pursuant to the statutory provisions under which Ginnie Mae operates, its net earnings are used to build sound reserves. In the opinion of management, Ginnie Mae is in compliance with OMB implementation requirements for the Federal Credit Reform Act.

U.S. Department of Housing and Urban Development

Andrew Cuomo
Secretary

Ginnie Mae

Kevin G. Chavers
President

Office of the President

Linda F. Benjamin
Sharolyn D. Moses
H. James Schwing
J. Nicholas Shelley

Office of the Executive Vice President

George S. Anderson,
Executive Vice President
Carlotta C. Bryant
Laura P. Pelzer
Susan M. Taylor
Patricia A. Dougherty
Carolyn L. Korn

Office of Program Administration

Janie R. Cousin
Helen M. Davis-Wood
Deborah V. Holmes
Betty Jo Jones
David Minor
Debra L. Murphy
Karen C. Overmiller
Maria C. Rojas
James A. Thompson
Sandra J. Usher
Thomas R. Weakland

Office of Customer Service

Shirley S. Bannister
Brenda S. Countee
Michael P. Daly
Sandra E. Dixon
David L. Ellis
Thelma A. Figueroa
Theodore B. Foster
Robert E. Fry, Jr.
Michael C. Garcia
Bryan Hooper
Anne Y. Humphrey
John Kozak
George I. Rose, Jr.
Paul R. St. Laurent, III
Tamara P. Smith
Richard J. Washington

Office of Multifamily Programs

Barbara A. Foreman
Paulette M. Griffin
Sharon L. LaTour
S. Daniel Raley

Office of Finance

Angela E. Aganad
Karen P. Beddoe
Linda D. Blaylock
Dan Cira
Victor M. Correa
Helen E. Faunce
Cheryl D. Gordon
Paul A. Imbraguglio
Robert L. Juenger
Maria M. McQueen
Michael J. Najjum, Jr.
Karmen L. Young

Office of Policy, Planning, & Risk Management

Marilyn E. Carlson
Charles A. Clark
Jeannette Hackett
Elton A. Peller
Sonya Keys Suarez
Wilson Thompson

Staff as of February 1, 1998